

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE
2004 SPECIAL 301 REPORT
PEOPLE'S REPUBLIC OF CHINA

EXECUTIVE SUMMARY

Special 301 recommendation: Despite extensive raiding on behalf of some industry sectors, piracy rates remain at over 90% across all copyright industries. IIPA again recommends that China remain subject to Section 306 Monitoring.

Overview of key problems in China: China has now been a WTO member for over two years and has been obligated under its bilateral arrangements with the U.S. (1995-1996) for 8-9 years. China can no longer excuse its failure to lower piracy rates to below 90%, among the highest rates in the world. Despite continued government expressions of concern and commitment to root out piracy (and many admissions of the seriousness of the problem) and a major anti-piracy campaign begun in September 2003, piracy rates have simply not come down. Exports, particularly of pirate DVDs, began again last year and continue at alarming levels, affecting even major markets like the U.S. and the U.K. OD factories, despite seizure of lines and some closures of underground factories (and a few deterrent sentences involving underground plants), continue to produce massive amounts of pirate product to satisfy a huge domestic demand which legitimate right holders, due to continuing market access restrictions (and piracy), are unable to satisfy. While the Chinese government continues to take some welcome action against pirates in certain industry sectors, applies administrative fines (which are notoriously low) and occasionally convicts a pirate under its various criminal provisions, piracy rates do not come down, indicating lack of coordination and deterrence in the system.

This lack of deterrent penalties for piracy as well as a lack of a coordinated, transparent enforcement program continue, in industry's view, to be a key cause for the failure of piracy rates to decline. Central to the problem is the failure of the Chinese government to commit to bring criminal cases against piracy *per se* (as distinct from the few prosecutions taken under other laws). This political unwillingness is combined with legal deficiencies, both in the substance of the criminal law provisions (which remain TRIPS non-compliant), and in the official "Interpretation" by the Supreme People's Court (high criminal thresholds and other procedural deficiencies making criminal enforcement virtually impossible), all resulting in the failure to apply the criminal law to piracy "in practice" in violation of TRIPS Articles 41 and 61. Despite promises to lower the thresholds that would permit deterrent criminal enforcement—an obligation from China's WTO Working Party Protocol—this much-needed first-step action has yet to be taken, though there are continuing, but unconfirmed, rumors that changes may be made. Also on the law reform front, IIPA has also recently learned that the Supreme People's Court has revised its "Interpretations" on how the copyright law is to be applied to Internet piracy (growing at alarming rates in China), but IIPA has not yet analyzed the changes.

Other piracy problems persist after years of prodding by industry and the U.S. government: (1) failure to devote sufficient resources to, and take effective action against, business and ministry unauthorized (unlicensed) use of business software; (2) failure to apply deterrent administrative penalties to the production, wholesale and retail sale of pirate

entertainment and business software, sound recordings, movies and books; (3) failure to take action under the criminal piracy laws against underground optical disk plants or against the massive import and increasing export of pirate product; (4) failure to effectively organize an effective enforcement infrastructure to fight growing Internet piracy; and (5) failure to coordinate enforcement at the Vice Premier level, though Wu Yi's apparent naming as IPR "czar" may bode well for a change.

China's fight against piracy is also severely hampered by onerous market access barriers (some enshrined in China's WTO agreements). These barriers severely hinder the ability of the copyright industries to satisfy growing demand (thus contributing to the high piracy rates) and prevent much-needed cooperation of government and industry in the fight against piracy.

Actions to be taken by the Chinese government: The following actions closely track IIPA's recommendations for 2003; industry's frustration at the lack of action has now reached the breaking point—

- Vice-Premier Wu Yi's overall responsibility for intellectual property issues must be accompanied by providing her full political support and resources to finally bring some overall national coordination to the anti-piracy effort and giving her the authority to revise the various "Interpretations" and regulations which now stand in the way of an effective market for copyrighted products in China;
- Immediately reduce or eliminate the high criminal thresholds (and accompanying procedural hurdles) that in practice prevent the effective application of the criminal law to piracy—the only way to significantly reduce piracy in China. Then, under Vice-Premier Wu Yi's leadership, establish a national anti-piracy criminal task force to deter OD factory, wholesale and retail, Internet, and enterprise end-user piracy of software, piracy of books, and piracy and counterfeiting of cartridge-based entertainment software with arrests and the imposition of severe criminal penalties. Amend the Criminal Code to clarify its full and effective application to all piracy crimes (including enterprise end user piracy of software), thus bringing it into compliance with TRIPS;
- Announce a national campaign to unleash this Anti-Piracy Task Force to prevent and punish criminal acts of piracy both internally and at the border;
- Significantly increase administrative fines for piracy and better utilize that process against all forms of piracy, including enterprise end user piracy of software;
- Through amended copyright legislation or regulations, correct the deficiencies in China's implementation of the WCT and WPPT, and ratify the two treaties;
- China must ensure that its WTO market access commitments are fully implemented and begin now to liberalize its business climate to permit effective operations by copyright industries.

PEOPLE'S REPUBLIC OF CHINA
ESTIMATED TRADE LOSSES DUE TO PIRACY
(in millions of U.S. dollars)
and LEVELS OF PIRACY: 1999 - 2003¹

INDUSTRY	2003		2002		2001		2000		1999	
	Loss	Level	Loss	Level	Loss	Level	Loss	Level	Loss	Level
Motion Pictures	178.0	95%	168.0	91%	160.0	88%	120.0	90%	120.0	90%
Records & Music ²	286.0	90%	48.0	90%	47.0 ²	90%	70.0	93%	70.0	90%
Business Software Applications ³	NA	NA	1637.3	92%	1140.2	92%	765.1	94%	437.2	91%
Entertainment Software ⁴	568.2	96%	NA	96%	455.0	92%	NA	99%	1382.5	95%
Books	40.0	NA	40.0	NA	130.0	NA	130.0	NA	128.0	NA
TOTALS	NA		1893.3		1932.5		1085.1		2137.7	

COPYRIGHT PIRACY AND ENFORCEMENT IN CHINA

China needs to take immediate steps to improve each of these enforcement mechanisms, particularly criminal enforcement, if China is to even approach the minimum standards for IPR enforcement established by the TRIPS Agreement.⁵

¹ The methodology used by IIPA member associations to calculate these estimated piracy levels and losses is described in IIPA's 2004 Special 301 submission at <http://www.iipa.com/pdf/2004spec301methodology.pdf>.

² The estimated losses to the sound recording/music industry due to domestic piracy are US\$286 million for 2003, and exclude any losses on sales of exported discs. This number is also based on a "displaced sales" methodology.

³ BSA's 2003 piracy statistics were not available as of February 13, 2004, and will be made available in the near future and posted on the IIPA website at <http://www.iipa.com>. BSA's statistics for 2003 will then be finalized in mid-2004 and also posted on the IIPA website. BSA's trade loss estimates reported here represent losses due to piracy which affect only U.S. computer software publishers in this country, and differ from BSA's trade loss numbers released separately in its annual global piracy study which reflect losses to (a) all software publishers in this country (including U.S. publishers) and (b) losses to local distributors and retailers in this country.

⁴ ESA's reported dollar figures reflect the value of pirate product present in the marketplace as distinguished from definitive industry "losses." The methodology used by the ESA is further described in Appendix B of this report.

⁵ United States Trade Representative, 2003 Report to Congress on China's WTO Compliance, December 11, 2003 at p. 51-2; <http://www.ustr.gov/regions/china-hk-mongolia-taiwan/2003-12-18-china.pdf>.

Optical disc piracy continues almost completely to dominate the local market, despite massive seizures of pirate product.

The levels of optical disc piracy in China continued across all lines of copyright business at critical levels (90% and above) in 2003 despite a record number of seizures in 2002 and 2001. Statistics for audiovisual product put out by the National Anti-Pornography and Piracy Working Group (NAPPWG) were revised upward for 2002 with the seizure of almost 115 million pirate disks—a staggering number indicating the massive dimension of the problem. The NAPPWC arrested 6,400 offenders in that year, and impounded 23 illegal production lines. This dwarfed the then-record 51 million pirate VCDs and 4.9 million DVDs seized in 2001. In 2003, by comparison (in the first eight months), 49.5 million discs were seized. The lowered amounts are reportedly due in part to the difficulties associated with the SARS epidemic. At the same time, 2,117 arrests were made. Through October 2003, 24 lines were seized. Since the China 1996 Enforcement Action Plan (with the U.S), NAPPWC reports that it has seized 180 production lines from both registered and underground OD plants. However, all this welcome and indeed necessary raiding and seizure activity has failed to make any dent in the marketplace, which remains dominated by cheap OD product—pirate DVDs, for example, sell in China for as little as \$0.95 per unit, the lowest price in the world. This is due to the massive quantity of pirate product in the market that continues to drive down its price. China has 71 OD factories with an estimated 569 production lines churning out optical media products containing protected content of all kinds.

As reported in the last few years' submissions, pirate production is not limited to underground, unlicensed plants that are found throughout China, many in locations more inaccessible than in the past. Registered/licensed plants continue to produce some pirate product. This has apparently not changed, though some dent may have been made by the NAPPWG raiding and the successful civil cases brought by the recording and motion picture industry against licensed plants. CD-R "burning" is also on the increase in China, as it is throughout Asia.

The gravity of the OD piracy problem has recently hit the motion picture industry particularly hard. The piracy rate has gone up in 2003 to 95%, the highest since 1996. Home entertainment (VCDs, DVDs etc) revenues to the U.S. motion picture industry have plummeted and in 2002 were less than \$3 million in a domestic market (legitimate and pirate) estimated at \$1.3-\$1.5 billion and in which the legitimate market was only 5% or \$65 million. At the same time, the number of VCD and DVD players in China exceeded 90 million in 2002 and is rapidly climbing. Theatrical revenues have also declined precipitously. MPA's losses have now reached their highest level since 1995: \$178 million.

While imports of pirate OD product continue from the rest of Asia, the most alarming new development is the rapid and unexpected growth of pirate OD exports in 2003. MPA reports, for example, that during the first three quarters of 2003, customs officials in the U.K. have witnessed a significant escalation in seizures of pirate DVDs originating in China. In the first quarter of last year, 2,000 DVDs were seized. In the second and third quarters, over 77,000 Chinese origin DVDs were seized, in spite of NAPPWC's seizure of 24 lines through the end of the third quarter. These exports have also reached the U.S. According to the statistics from the Department of Homeland Security, seizures of "media" (including pirate optical discs) shipped from China to the United States accounted for US\$1.7 million and amounted to 6% of the total IPR seizures involving China in the first half of 2003.

The crisis in the local music industry continues for a fourth year in a row. This year, the industry has revised its methodology of calculating losses in China to count estimated displaced sales. Losses are estimated at \$286 million in 2003 with the piracy rate remaining at 90% of the market. Cassette piracy remains a significant factor in China but pirate CD production for the local market has taken a huge toll on domestic producers as well as on U.S. record companies, who also face severe market access restrictions. The recording industry remains encouraged by the cooperation of the courts in imposing civil damages against pirate plants but without real criminal remedies doubts whether the piracy level can decrease.

Piracy of entertainment software in OD formats remains prevalent in the Chinese market. High quality factory produced pirate entertainment software products (in the English language) are widely available in the market, though it is unclear whether production is taking place in China or elsewhere. CD-R burning of pirate material continues to increase. Sony Playstation® entered the market in full force in 2003 but faces massive piracy challenges. Pirate entertainment software for the console format sells for between US\$0.85 and \$3.00, as opposed to the US\$20.00 retail price for legitimate product (priced specifically for the Chinese market and significantly lower than the average retail price for the U.S. market). Unauthorized console machines, all containing mod chips allowing the play of pirate games, sell for around \$180 vs. \$240 for the legitimate console. Nintendo also announced its entry into the Chinese console market in 2003. The company will be marketing a console specifically developed for China in an effort to thwart piracy. It is critical that China amend its copyright law to ensure that enforcement against circumvention devices like mod chips can be fully effective, including making the trafficking in such devices a criminal offense which does not exist under current law.

Enterprise end-user piracy of business applications software causes the highest losses to the software industry, followed by counterfeiting and hard disk loading.

As in other countries, unauthorized use of software in enterprises in China causes the great majority of piracy losses faced by the business software industry. The software industry has struggled for years to persuade NCAC to devote sufficient resources to raiding/auditing enterprises that use unauthorized software. Very few such cases have been brought and concluded, and those few only very recently. The trend has been encouraging with respect to the Chinese civil court system's willingness to take on and decide end-user cases. There have been, as of this date however, only four such cases. The first two, involving AutoDesk and Adobe, were decided in favor of the copyright owner but evidence of actual damages (which were substantial—in one case over US\$250,000) ended up being rejected and the cases were decided under the new statutory damages provisions of the copyright law amendments. In one case the damages were RMB500,000 (US\$60,410) and in the other RMB115,000 (US\$13,894 including court costs). A third case was settled under pressure from the judge for only RMB50,000 (US\$6,040) In the fourth case, against a large interior design company in Beijing with 15 operations, NCAC finally agreed to raid two locations. After about eight months, NCAC awarded only RMB270,000 (US\$32,621) in fines and the copyright owner then sought to bring civil actions in the courts against four other branches of the enterprise. In October 2003, the Beijing High Court, for the first time ever, awarded damages based upon the number of copies times the retail price—a total in damages of RMB1.49 million (\$180,021). While this is a major victory for the software industry (the decision is on appeal), any significant dent in the rate of software piracy in China will need the widespread application of administrative enforcement by

NCA and the criminalization of enterprise end-user piracy. NCA has regularly balked at bringing administrative cases against enterprise end-users and when it has acted, has unfortunately not rendered deterrent penalties. Indeed, only a very few such administrative actions have been brought. The NCAC released a “Circular on Printing and Distributing Implementation Scheme for Movement Outline of Work Plan to Revitalize the Software Industry (2002-2005) Fight against Pirated Software.” This document refers to retail piracy, hard disk loading and Internet piracy but fails to mention enterprise end-user piracy, the most serious form of software piracy.

The government, through the State Council, the NCAC and the Ministry of Information Industry, should issue a policy statement or order, accompanied by a national public education campaign, requiring enforcement authorities to more vigorously enforce the law against enterprise end-user piracy.

Unauthorized use of software in government ministries remains a problem, even though in February 1999, the State Council reissued a “Notice” originally released by the National Copyright Administration of China in August 1995 ordering all government ministries at all levels to use only legal software (the so-called “Red Top Decree”). A number of other decrees requiring the legal use of software were issued after this, including a joint decree by four ministries. Some progress has been made but the problem continues to persist, causing large losses for the industry. The value of these decrees is in showing transparent implementation not only to the software industry but also, more important, to the private sector. The government should issue a public report on the status of its internal legalization.

While enterprise end-user piracy is the most pressing problem for the business software industry in China, counterfeiting and hard disk loading are also major problems. Indeed, China is the source of some of the most sophisticated counterfeit software anywhere in the world. Industry representatives report that high quality counterfeits are produced in large quantities both for the domestic Chinese market and for worldwide distribution, with software available in multiple languages. In order to deal with the counterfeit and hard disk loading problem, the Chinese government needs to: 1) undertake legislative reform to facilitate criminal investigations and prosecutions (including refining the standards for criminal liability for copyright and trademark offenses); 2) allocate sufficient resources to justice and enforcement officials charged with investigating these types of IP-related crimes; 3) engage in sustained crackdowns on the manufacture, distribution and sale of pirate software; and 4) strengthen mechanisms for both intergovernmental and public/private sector cooperation in this area.

Internet Piracy

Internet piracy continues to grow rapidly in China, with a reported 78 million people now on line (up from 58 million users in 2002 and 33.7 million in 2001). While China appears to recognize the problem and has reportedly recently issued new “Interpretations” dealing with Internet infringements and is working on more comprehensive regulations on the subject, further delays in establishing a full legal and enforcement infrastructure must be avoided.

A large number of websites provide fee-based or free download services (or streaming of musical recordings) without permission. A large number of Chinese ISPs are also hosting these infringing websites organized by overseas syndicates targeting users outside China—again involving China in the “export” of pirate products.

While Internet piracy has primarily targeted the music industry, motion pictures, business and entertainment software and academic journals are also significantly affected. For audiovisual works, this piracy, which is increasing, involves the sale of “hard goods” (VCDs and DVDs—all formats) as well as the illegal streaming of films. In the first seven months of 2003, MPA has issued 231 cease & desist letters to ISPs in China, requesting the ISPs to “take down” infringing websites. However, the compliance rate is an unacceptably low 37%. The new “Interpretations” and Internet regulations, plus more effective deterrent enforcement, must change this result.

For the entertainment software industry, piracy at Internet cafés remains a significant problem. In 2002, IIPA urged the Chinese government to look into the use of entertainment software at these cafes, citing the fact that while the government had been vigilant in requiring cafes to install blocking software for pornographic and subversive sites, the issue of piracy of entertainment software products has not been addressed. To our knowledge, there still have been no efforts to address this situation. In 2003, some entertainment software companies slowly began licensing Internet cafes; however, a large number of these establishments will continue to use both unlicensed and/or pirate video games unless the government begins to address this problem. Although the government reportedly announced, in early 2003, that it would launch a crackdown on Internet game piracy at Internet cafes—which would have been a promising step in combating such piracy—there has been no such action taken, as far as is known to the industry.

Book and journal publishers report a significant, and growing, Internet piracy problem, especially in the electronic academic journal sector, in 2003. Downloads of entire books is also a problem. In fact, publishers now report more illegal downloads of online journals as well as digital license violations in China than anywhere else in the world. Journal publishers have been working with librarians to try to minimize unauthorized file transfers and to prevent pirate “document delivery services” from developing, but the Chinese government must work to promote digital copyright compliance as well.

Internet piracy continued at crisis levels for the recording industry in 2003, and, as predicted in last year’s submission, the situation has worsened. Not counting music files (mainly MP3, but increasingly in Microsoft’s Windows® Media format) being exchanged through FTP servers set up by university students, and other peer-to-peer servers (such as the Taiwan-based Kuro), RIAA/IFPI estimates that there millions of music files being offered for download and listening (through audio streaming) from over a thousand active pirate music websites in China.

RIAA/IFPI has been engaged in an active campaign to warn ISPs about their infringing activities. In a number of cases, RIAA/IFPI located sites that were offering new releases of Western artists for downloading with their MP3 files mainly stored in servers located in China.

One welcome development was the order issued in November by a court in Chengdu, China’s Sichuan Province, ruling against one of China’s most popular websites for illegal downloads of music, “Tianfu.” The plaintiffs were three Hong Kong record companies, and the damages awarded were significant, though still too low given the damage done, RMB370, 000 (US\$45,000). With many of these civil damage judgments of recent vintage, Judge Jiang Zhipei’s recent statement that “A [civil] judicial system to protect intellectual property right is now basically established in China” is coming closer to realization.

Piracy of Journals and Books

Last year's submission details the successful effort of AAP and other publishing industry associations in dealing with the print journal piracy problem.⁶ The improvements obtained in this area appeared to be holding in 2003, and the Chinese government is to be commended for its efforts in keeping this piracy rate low. However, publishers are noticing a significant increase in electronic journals piracy. The Chinese government must work diligently with right holders to ensure that the government's success in reducing print journals piracy is not undermined by these increases in electronic piracy.

Unfortunately, the successes against journal piracy have not carried over into efforts to combat piracy of other literary materials. Traditional reprint piracy continues to remain a major problem in China, particularly of higher education textbooks. Professors, through lack of education or lack of government instruction or enforcement, often openly solicit pirated goods. The Chinese government needs to take action against textbook piracy with the same vigor with which it tackled journal piracy. Reprint piracy affects the market for trade books as well. J.K. Rowling's latest Harry Potter book, "Harry Potter and the Order of the Phoenix," was again heavily pirated both in print and over the Internet.

A problem on the rise in China is illegal commercial photocopying. While photocopying has traditionally taken second place to print piracy in China, decreasing costs of photocopy paper and other necessary materials are resulting in increasing levels of this type of activity. This is especially prevalent among secondary schools and English language teaching programs. Many of these programs draw students by advertising their use of full color, high quality books, and then provide photocopies of books to students upon enrollment.

Counterfeiting problems also abound. IIPA has previously reported the publication of totally bogus books purportedly written by a famous author. This happened most recently with the Harry Potter series, with Chinese publishers producing at least three additional books about Harry under Rowling's name. One of the publishers was caught and subjected to a \$2,500 fine.⁷ Furthermore, well known business and academic trademarks, such as those of the Harvard Business School, are used illicitly to promote sales of books by implying a nonexistent affiliation or endorsement.

Finally, translation piracy remains a problem for foreign publishers. Publishers continue to report production of illegal translations, of both textbooks and bestsellers, largely by second-channel distributors. The scope of this problem grows larger in smaller cities and provinces.

Piracy and Counterfeiting of Cartridge-Based Entertainment Software

China remains the primary source of counterfeit and pirate cartridge-based entertainment software products. Counterfeit Nintendo products continue to be produced in mass quantities in China, and exported throughout Asia, Latin America, the Middle East and Europe. Nintendo has undertaken significant anti-piracy efforts in Guangdong Province, though these actions have been taken largely under the trademark law to protect the globally famous "Game Boy" brand. While trademark actions have generally proven easier to prosecute than

⁶ See IIPA's 2003 Special 301 country report on the People's Republic of China, pages 25-26, available at <http://www.iipa.com/rbc/2003/2003SPEC301PRC.pdf>.

⁷ Id.

copyright cases, available penalties are equally low. The efforts of the Chinese administrative authorities (specifically in Guangdong Province), in cooperation with Nintendo representatives, have resulted in raids against a number of retail shops and at least 19 factories, resulting in the seizure of 1,286,356 counterfeit Nintendo products. The raids against factories, however, have not resulted in a significant reduction in factory-capacity to produce counterfeit cartridge-based video games. There have been many instances where, despite a raid on the factory premises and an ostensible shutdown and seizure of the infringing goods, the very same factory continues its operations, albeit under a different corporate name and at a different location.⁸ Unfortunately, as noted, fines remain woefully low to make any real dent in the marketplace. Raids against these factories have also revealed that they are (directly or indirectly) connected with Hong Kong and Taiwanese factories (for instance, funding was often supplied by a Taiwanese national, or a Hong Kong “affiliate” office often served as a conduit for transmitting orders to the factory on the Chinese mainland).

Other Types of Piracy

Other types of piracy also continue in China, including the unauthorized public performance of U.S. motion picture product, which continues mostly unchecked in hotels, clubs, mini-theaters and even government facilities; television piracy, particularly at the provincial and local level; and cable piracy (over 1,500 registered systems) which routinely pirate U.S. product.

WHILE RAIDING AND SEIZURES CONTINUE AT HIGH LEVELS, LOW ADMINISTRATIVE FINES AND THE LACK OF CRIMINAL ENFORCEMENT AGAINST PIRACY HAVE MEANT THAT THERE IS LITTLE, IF ANY, DETERRENCE IN THE COPYRIGHT ENFORCEMENT SYSTEM.

To meet its WTO/TRIPS commitments on enforcement and particularly TRIPS Articles 41, 50 and 61 (provide enforcement which “on the ground” deters further infringements, provide effective *ex parte* civil search orders, and provide specific deterrent “criminal” remedies), China must implement a system in which the State Council ensures that the authorities (a) cooperate more closely with affected industries; (b) make the system far more transparent than it now is; (c) make fighting piracy a national priority articulated at the State Council level on a regular basis; (d) give Vice Premier Wu Yi the “publicly announced” authority to intervene at all levels and to coordinate the nationwide enforcement effort; (e) significantly increase administrative penalties and actually impose them at deterrent levels; and (f) increase criminal penalties, lower the criminal thresholds and actually criminally prosecute, convict and impose deterrent fines and

⁸ For example, in October 2002 and January 2003, Chinese administrative agencies raided the “Electronic Dragon” production facilities at which over 49,000 counterfeit *Game Boy Advance* cartridges and components were confiscated. During post-raid surveillance, the company found that the factory had resumed operations in a different location under a new company name. A subsequent raid on the new location was conducted in July 2003 and more than 78,000 counterfeit *Game Boy Advance* cartridges and semiconductor chips were seized. The principals all fled China and authorities have been able to take no further action against them. Such actions by the pirates and difficulties enforcing against them indicates how well-developed and sophisticated these manufacturers and distributors have become. Such organized criminal behavior demands a coordinated national response from the Chinese government.

prison sentences on pirates. None of these objectives has as yet been either fully articulated let alone accomplished.

In IIPA's 2003 submission, we detailed the lack of deterrence in the system despite significant raiding and massive seizures of pirate product. Little has changed in 2003, though there have been a few notable successes in the administrative tribunals and the civil and even criminal courts in 2003, as detailed both above and below. While these are positive steps, they have not resulted in piracy rates being reduced; indeed, in some industries they have increased.

IIPA also recently learned that the Ministry of Culture plans to introduce a new "hologram" system ostensibly to combat piracy in the local market.⁹ IIPA members do not favor this solution to the problem of piracy. Not only are holograms themselves generally prone to counterfeiting (and thus would "legitimize" otherwise pirate product), but are costly to right holders, burdensome, and cause delays in releasing legitimate product (and again will foster piracy). Most important, they have proven generally ineffective in practice, are thus counterproductive and are no substitute for the kind of aggressive and coordinated enforcement so desperately needed in China. We urge the Ministry to reconsider its decision and to consult fully with right holders with experience in this area.

Administrative Enforcement

As noted above, NAPPWC appears to be the most effective administrative enforcement mechanism in China, with a continued large number of raids, seizures and arrests. NCAC's title verification program continues to work well for only one industry—the motion picture industry—with, from 1996 to August 31, 2003, a total of 10,021 title verification requests submitted by MPA, and 3,477 titles found to have been unauthorized.

However, NCAC's record in levying deterrent fines and actually conducting, for example, actions against corporate end-users of business software has been abysmal, particularly in light of the fact that other critical remedies, such as under the criminal law, are virtually unavailable to right holders.

Even with the myriad arrests by NAPPWC, the lack of transparency in the enforcement system, particularly the lack of industry access to levels of fines and other penalties for infringement, makes it almost impossible to judge whether there have been advances in deterrent enforcement. We do know, however, that the piracy rates remain universally high and thus we have no alternative but to conclude that the administrative enforcement system is not having any serious impact in the marketplace. This is not to say that industry does not welcome or does not fully support these efforts, simply that the Chinese government must focus on **deterrence** as the key to reducing piracy rates. To date it has not done so. The following summarizes the deficiencies in the administrative enforcement system:

- Fines are too low, both as written and as imposed; these need to be increased significantly, imposed in practice and widely publicized throughout China, and the results provided to the U.S.G. as promised in the bilateral IPR agreement.

⁹ China Plans Anti-Piracy Seals to Combat Counterfeiting, Associated Press, February 10, 2004. http://online.wsj.com/article/0,,BT_CO_20040210_000792.00.html

- The system is almost entirely nontransparent; it is, with some recent exceptions, impossible to ascertain what penalties are imposed in particular cases. This extends to the Chinese public as well as to foreign right holders. Right holders cannot, for example, obtain documents from the government on the activities of CD plants (even though every order the plant accepts must be recorded and reported to the authorities). Foreign right holders are usually told that these are “national confidential documents.” IIPA members have no evidence that these practices will change.
- There is a lack of time limits for investigations, leading to long delays and a resulting failure to deter pirates.
- There is still “local protectionism” by administrative agencies involving politically or financially powerful people engaged in pirate activities.
- NCAC continues to fail to use its authority to deal with the all-important problem of corporate end-user software piracy.

CHINA ADMINISTRATIVE COPYRIGHT ENFORCEMENT STATISTICS FOR 2003

ACTIONS	MOTION PICTURES
Number of raids/searches conducted	1,409
Number of administrative cases brought by agency	811
Number of defendants found liable (including admissions/pleas of guilt)	803
Ratio of convictions to the number of raids conducted	57%
Ratio of convictions to the number of cases brought	99%
Number of cases resulting in administrative fines	N/A
Total amount of fines levied	N/A
US\$0-\$1,000	N/A
\$1,001-\$5,000	N/A
\$5,001-\$10,000	N/A
\$10,000 and above	N/A
Total amount of restitution ordered in how many cases (e.g. \$XXX in Y cases)	N/A

Criminal Enforcement

IIPA and its members (and the USG) have pressed China for years to use its criminal law to prosecute pirates, since it is the only viable means effectively to reduce piracy levels in China. While criminal enforcement does occur under other laws such as those dealing with pornography or running an illegal business (Article 225 of the Criminal Code), it will be difficult for China to convince its people that piracy is an economic crime that damages the Chinese economy and Chinese culture until there is a publicly announced commitment from the State Council/Vice-Premier level and an ample record of convictions with deterrent penalties. As discussed in detail below, the piracy provisions in Article 217 and 218 of China’s criminal law have rarely been used because of the high thresholds established by the Supreme People’s Court in its “Interpretations” of these provisions. These thresholds must be substantially lowered, and the “Interpretations” otherwise amended, to permit effective criminal prosecutions.

IIPA members have consistently had difficulty in gathering information on the use of the criminal law against acts of piracy. When we hear of convictions, we discover that they are

usually under other laws, like pornography or “illegal business,” not piracy. China publicly announces the seizure and destruction of pirate product on a regular basis, but seems to rarely publicly announce a jail term or deterrent fine for piracy *per se*. This must change. This year, however, one IIPA member was able to unearth some statistics: In 2002 19 criminal cases were brought and concluded (with reported sentences of six months to 6 years) in Beijing involving that industry’s products—apparently none in any other city. In 2003, 30 cases were filed in Beijing and Shanghai, with again, 80% in Beijing. Only 3 of these cases were brought under the criminal “piracy” provisions, Article 218, the high threshold having been met in those 3 out of 49 total cases over 2 years. The rest of the cases were basically censorship cases brought under Article 225 of the Criminal Law. Jail terms were, however, significant in most of these cases, indicative of the fact that a criminal prosecution, as contrasted with an administrative proceeding, is likely to result in some deterrence—if properly and widely publicized and directly identified with piracy.

We have also heard from Chinese representatives that there have been other criminal convictions specifically prosecuted under the criminal piracy provisions, though the ones cited have involved Chinese origin works and all have admitted that these cases are very, very few. We have inquired on many occasions about the existence of criminal convictions purely for piracy offenses and we have received no confirmations.¹⁰

Bringing criminal cases was not only an obligation in the US-China 1995 Memorandum of Understanding and [Enforcement and Market Access] Action Plan, but is a clear TRIPS requirement. China is not now in compliance with either that bilateral agreement or TRIPS. We again urge the USG to press the State Council to fulfill its commitment to recommend to the Supreme People’s Court that its “Interpretations” be significantly amended to make criminal prosecutions more available. As further discussed below, the State Council has ultimate authority to order that these amendments be made.

Except for the statistics cited above, no other industry reports having a criminal case—for piracy—brought or concluded with respect to their products. Indeed, the recording industry, which has brought myriad civil cases against licensed OD factories, continues to voice its frustration that the criminal authorities (the Public Security Bureau) are not taking actions against underground plants where civil actions are not possible.

While the copyright industries welcome actions under Article 225 of the Criminal Law, real deterrence won’t be brought to the criminal system until a significant number of widely publicized cases are brought under Articles 217 and 218. For this to happen, there must be political will and modifications of the Supreme People’s Court’s criminal law “Interpretations,” discussed below.

¹⁰ 2002 may have marked the year of the first pure piracy case ever, involving a factory in Guangdong Province, where two defendants were sentenced in March 2002 to 2 years’ imprisonment for copyright piracy only. This case involved the Foshan Jinzhu Laser Digital Chip Co. Ltd., which had accepted a phony order for 920,000 DVDs from a Taiwan defendant [who was fined RMB 400,000 (\$48,000)]. In addition to the prison terms, three lines were removed, and the GPPA revoked the plant’s license. There were other rumors of criminal piracy convictions in Anhui Province but no confirmation was obtained. Another case in Shanghai involved the *Dictionary of Cihai*, but again it appears that this was not a pure copyright case. IIPA has received informal reports of two book-piracy cases which were decided purely under Article 217 and 218, but these may be the Anhui cases for which we have no confirmation.

CHINA CRIMINAL COPYRIGHT ENFORCEMENT STATISTICS FOR 2003

ACTIONS	MOTION PICTURES
Number of raids conducted	41
Number of VCDs seized	23,252,990
Number of DVDs seized	8,478,590
Number of CD-Rs seized	12,575
Number of investigations	1,082
Number of VCD lab/factory raids	16
Number of cases commenced	31
Number of Indictments	5
Number of defendants convicted (including guilty pleas)	15
Acquittals and dismissals	-
Number of cases Pending	26
Number of factory cases pending	N/A
Total number of cases resulting in jail time	4
Suspended prison terms	
Maximum 6 months	-
Over 6 months	-
Over 1 year	-
Total suspended prison terms	-
Prison terms served (not suspended)	
Maximum 6 months	2
Over 6 months	-
Over 1 year	5
Total prison terms served (not suspended)	N/A
Number of cases resulting in criminal fines	N/A
Up to \$1,000	
\$1,000 to \$5,000	
Over \$5,000	
Total amount of fines levied (in US\$)	N/A

CIVIL ENFORCEMENT

As noted above, one positive development is the increasing sophistication and effectiveness of the IPR courts throughout China. For this reason, Chinese right holders and, increasingly, U.S. right holders have used the civil system as a means to bring some deterrence to the enforcement system in China, given the demonstrated failures of the criminal and administrative enforcement systems. The recording industry has brought over 150 cases against factories and many others against distributors and retailers since it began to use civil litigation in 2001. Also included were further cases involving illegal distribution of MP3 files on the Internet. Many of these cases have been completed and some of these cases resulted in significant damages. It is reported that these cases have had a deterrent effect, particularly on the licensed plants that were engaging in pirate activities.

The motion picture industry has also embarked on a civil litigation program, with a total of eight civil cases having been brought under the recent Copyright Law amendments during the past 12 months, all of them successful. In Beijing, two cases against factories were settled while six cases against three retail outlets resulted in court findings against the retail operators in each case. The difficulties we reported on last year appear to have been ironed out.¹¹

¹¹ See IIPA's 2003 Special 301 country report on the People's Republic of China, page 31, available at <http://www.iipa.com/rbc/2003/2003SPEC301PRC.pdf>.

As discussed in detail in prior submissions, the new copyright law amendments have made certain positive changes that should assist in bringing successful civil cases against infringers.

- Provisional remedies were added in Articles 49 and 50 and, as we understand it, it is intended that these operate on an *ex parte* basis.
- Court-determined “pre-established” damages can now be awarded up to a maximum of RMB500, 000 (US\$60,000) where the “actual losses suffered by the holder of the right or the profit earned by the infringing party cannot be determined.”

These changes are significant improvements, though U.S. right holders have continued to have some problems in successfully bringing civil cases in China, particularly the business software industry.

We have reported in detail above on the four civil cases reported by BSA involving software piracy. BSA remains concerned, however, that evidence preservation orders are still coming too slowly and are too difficult to obtain, in view of China’s TRIPS obligations in this important area.

In the area of piracy of literary works—in a major salutary development—a Beijing Intermediate Court rendered a judgment in September 2003 (in a case commenced in 2000) which sought damages against the Beijing New Oriental School. This school had for years administered the TOEFL and GRE tests to Chinese students seeking entrance into U.S. universities. ETS alleged that the school has been stealing ETS’s highly secure test questions and test forms and selling them to its students at a significant profit. The school also distributed these highly secret test questions widely in China. ETS claimed that the security and integrity of the tests have been compromised to the extent that it has led some U.S. universities to doubt the authenticity of all test scores from China, harming the entrance prospects of Chinese students. (Over 10% of the 800,000 students taking the TOEFL test worldwide come from China). New Oriental had been unsuccessfully sued before and the size of the infringement was staggering, with New Oriental adding an average of 10,000 students per month and with a nine-month waiting list. The court finally concluded a case that had been rife with procedural hurdles, and awarded damages of US\$1.2 million to both ETS and GMAT. Again, this bodes well for improving civil enforcement in China.

Enforcement Against Internet Piracy

Due to the rapid growth of Internet piracy in China, some of the copyright industries have begun concerted enforcement campaigns. MPA began such a program in earnest in May 2002, employing web crawlers that can find pirate movies both in English and simplified Chinese characters. As reported above, in 2003, 231 cease and desist letters were issued and the compliance rate decreased to 37% from 41% in the prior year. We now await a review of the new Internet “Interpretations” and the timely issuance of the new Internet regulations with the hope that this system can improve significantly.

The recording industry, facing massive Internet piracy in China, has continued to issue cease and desist letters to offending ISPs and websites, FTP sites etc. in 2003. Compliance

has generally been good by the ISPs but litigation and *ex officio* action by Chinese enforcement authorities will be necessary to make a significant difference. RIAA/IFPI has brought a number of civil suits against ISPs and websites, which have been reported, in earlier submissions. Some success has been achieved.

STATUTORY LAW AND REGULATIONS

The new copyright law amendments and regulations remain deficient in implementing China's TRIPS obligations as well as the provision of the WIPO "Internet" treaties.

The amendments to China's 1990 copyright law were adopted on October 27, 2001, and IIPA's 2002 and 2003 submissions provide great detail on both the positive changes, as well as the deficiencies, in these amendments.¹² The amendments sought to bring China into compliance with its WTO obligations and added many provisions that sought to implement the requirements of the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT). The deficiencies detailed in these prior submissions were not fixed by the December 2001 regulations governing computer software, or the regulations to the Copyright Law which became effective on September 15, 2002.

Again worthy of particular emphasis, however, is the failure of these amendments to address the lack of TRIPS-compatible criminal remedies, probably the single most important change that must be made to open up the Chinese market closed by staggering piracy rates of over 90%.

Section 217 and 218 of the Criminal Code criminalizing copyright piracy must be amended to comply with TRIPS; the Supreme People's Court's "Interpretations" of these provisions must likewise be amended.

IIPA has noted in prior submissions that the criminal piracy articles of Chinese law are deficient on their face, and thus violate TRIPS Article 61, which requires the criminalization of all "copyright piracy on a commercial scale." These articles must be amended, *inter alia*, (1) to criminalize end-user piracy; (2) add reference to all the exclusive rights now provided in the law, particularly the new WIPO treaties rights and unauthorized importation; (3) add criminalization of violations of the anti-circumvention provisions and rights management information; (4) criminalize Internet offenses that are without "profit motive" but that have impact on rightholders "on a commercial scale"; (5) eliminate distinctions between crimes of entities and individuals; and (6) increase the level of penalties overall.

¹² See IIPA's 2003 Special 301 country report on the People's Republic of China, pages 33-36, available at <http://www.iipa.com/rbc/2003/2003SPEC301PRC.pdf>. Copyright Law of the People's Republic of China, Adopted at the Fifteenth Session of the Standing Committee of the Seventh National People's Congress on September 7, 1990, Amended in Accordance with "Decision to Amend Copyright Law of the People's Republic of China," Adopted at the Twenty-Fourth Session of the Standing Committee of the Ninth National People's Congress on October 27, 2001 (translation on file at IIPA).

We have noted that there is an urgent need to revise the current SPC “Interpretations” of the existing criminal law Articles 217 and 218. We understand that this has now been completed at this time. It is critical that the “threshold” not only be significantly reduced or eliminated (particularly with Internet offenses when not done “for profit”), but that the other procedural deficiencies are remedied as well. These deficiencies include calculating income at pirate prices (rather than the legitimate price in China) and calculating income only on the basis of what is found to have actually been distributed/sold, not what pirate product may be sitting in a warehouse. This is one of the highest priorities for U.S. industry. Such a commitment is contained in the U.S.-China IPR WTO Working Party “Protocol,” but in a manner committing the State Council only to “recommend” such change. The State Council has ultimate authority to make these changes directly. The USG must continue to press the State Council to redeem this commitment.

Application of the Copyright Law to Internet disputes: Supreme People’s Court “Interpretations” and the need to ratify the WIPO Copyright and Performances and Phonograms treaties and amend the Copyright Law to fully meet all those obligations.

IIPA has recently been told that new “Interpretations” were recently issued by the PSC. They remain in Chinese and IIPA has not yet had a chance to analyze them. In last year’s submission, we detailed the positive and deficient provisions of the existing “Interpretations” and do hope that these observations were taken into account. Since Internet piracy is growing in China, it is critical that the legal infrastructure for protecting copyright on the Internet -- through amendments to the copyright law, to the copyright and software regulations (which we understand are in process) and to the SPC “Interpretations” – be modernized to take into account the substantive law and enforcement associated with this type of piracy. We commend the Chinese authorities for being aware of these issues and hope that early modifications can be made in a transparent process that takes into account the vast experience our industries have accumulated globally on this critical topic.

IIPA also urges China to ratify the WIPO “Internet” treaties and to make the amendments to the Copyright Law and regulations to fully implement their obligations. The amendments that IIPA believes are necessary were detailed in the 2003 submission.¹³

China must eliminate its onerous market access restrictions and create a competitive marketplace that can meet domestic demand.

Most of the copyright industries suffer from non-tariff and tariff trade barriers, which severely limit their ability to enter into business, or operate profitably, in China. These are only selected barriers that affect the named industries:

Entertainment software: Entertainment software titles must go through an approval process at the Chinese Ministry of Culture before distribution is allowed. In many instances, the approval process takes several weeks to complete. In the interim, pirate copies of popular games are already readily available in the market, localized into Chinese, before the legitimate

¹³ See IIPA’s 2003 Special 301 country report on the People’s Republic of China, pages 33-36, available at <http://www.iipa.com/rbc/2003/2003SPEC301PRC.pdf>.

product has been approved for distribution. In addition, there are other investment and ownership restrictions that must be abolished.

Book and journal publishing: In IIPA's 2003 submission, we detailed some of the existing barriers for the U.S. publishing industry. By December 11, 2004, many of these barriers must disappear in accordance with China's WTO commitments. At that time, publishers must be afforded full trading rights (the right to freely import directly into China), and be permitted to engage (with wholly owned companies) in wholesale and retail distribution activities. But there are other essential activities for which China's WTO commitments must be clarified and/or its existing regulations repealed, including the right to publish and print books and journals in China without restrictions (except for a transparent, quick and non-discriminatory censorship regime) and the right to invest freely in all manner of publishing related activities without ownership restrictions.

Motion picture industry

Import quotas: Limits on the number of films imported into China continue. Under the terms of China's WTO commitment, China has agreed to allow 20 revenue-sharing films into the country each year, up from a previous limit of 10. The Chinese are insisting that the 20 are a "maximum," not a "minimum." This interpretation is not in accordance with WTO policy and should be corrected. Moreover, the needs of the market far exceed the legal films now available as demonstrated by the huge market in pirated optical discs. Censorship and the monopoly import structure are the tools by which these quotas are imposed and enforced. China must begin immediately to dismantle all these archaic, protectionist and discriminatory restrictions.

Monopoly on film imports and film distribution: China Film continues to be the monopoly importer and distributor of imported films. China Film is capable of handling effectively only 7-8 films a year. This restriction of legal film supply leaves the market to the pirates and they are taking full advantage of this limitation. China should begin now to eliminate all barriers to the import and distribution of films, including all investment and ownership restrictions.

Cinema ownership and operation: Current law restricts foreign ownership of cinemas to no more than 49%. Foreigners are not permitted to operate cinemas. For the growth and health of the industry, foreigners should be allowed to own and operate cinemas.

Broadcast quota: Foreign television programming is restricted to no more than 25% of total air time and no more than 40 minutes of prime time between 6:00 PM and 10:00 PM on terrestrial stations and pay television systems. Since June 2000, foreign animation must follow the same censorship procedure as general programming and is restricted to no more than 25% of total air time and cannot exceed 40% of total animation programming delivered by each station. The quota on airtime should be raised to at least 50%, and the prime-time quotas should be eliminated altogether. China should begin now to eliminate all these discriminatory restrictions.

Retransmission of foreign satellite signals: Foreign satellite channels may only be shown in four- or five-star hotels, government buildings and foreign institutions. Moreover, foreign satellite channels beaming into China are required to uplink from a government owned satellite for a fee of \$100,000, placing a significant and unnecessary financial burden on satellite channel providers. The up-linking fee should be eliminated

because it inhibits the development of the television market. Indeed, all these restrictions and barriers should be eliminated.

Television regulations: Under the 1997 Foreign Investment Guidelines, companies that are wholly or jointly owned by foreign entities are strictly prohibited from investing in the broadcast industry. MPA member companies are not allowed to invest in broadcast stations or pay television systems. China TV Program Agency, the government acquisition arm, must approve all importation of foreign programming. All such restrictions should be abolished along with other foreign investment restrictions embodied in the June 1995 foreign investment guidelines, which restrict investment, on a wholly owned basis, in other important segments of the film, video and television industries.

Taxation: The theatrical and home video industries have been subject to excessively high duties and taxes in China, totaling over 50% and 75%, respectively. These levels have a significant impact on revenues and continue to hinder market access. With its accession to the WTO, however, China committed to reducing import duties by approximately one third and will now apply a specific rate of duty to both theatrical (reduced from 9% to 5%) and home video imports (reduced from 15% to 10%). These should be fully and fairly implemented.

Internet regulation: To monitor the Internet, economic and telecommunication-related ministries have staked out their turf on the web and have drafted competing regulations that are often vague and inconsistent. The State Council has been charged with creating a clear, effective and consistent Internet policy. Until the State Council completes its work, however, the landscape of existing regulations will remain confusing, with the Internet governed by regulations promulgated by a dizzying array of ministries and agencies. A stable, transparent and comprehensive set of regulations is necessary to guide the development of the Internet and e-commerce in China. China has also attempted to regulate and censor content on the Internet through regulation and technological controls. For example, the State Secrecy Bureau announced in January 2000 that all websites in China are to be strictly controlled and censored. In addition, the State Council set up the Internet Propaganda Administration Bureau to “guide and coordinate” website news content in April 2000. Jointly issued by the State Press Publication Administration and the Ministry of Information and Industry, the Provisional Regulation on Management and Control of Internet Publications became effective August 1, 2002, providing an additional mechanism for the government to intensify supervision of newspapers, periodicals, books and audio-visual content available online. The Ministry of Culture published “Interim Regulations on the Administration of Internet Culture,” effective July 1, 2003. These regulations require that providers of Internet-based content (with any broadly defined “cultural” attributes) receive MOC approval prior to distribution in China.

From a technological standpoint, China maintains firewalls between China and foreign Internet sites to keep out foreign media sites, and regularly filters and closes down Chinese sites that are seen as potentially subversive. In September 2002, for example, both the Google and Alta Vista search engines were blocked without explanation or acknowledgement by the government. While the industry respects the rights of China to ensure that its population is not subject to content that may be questionable under Chinese values, the breadth of China's restrictions on the Internet are unprecedented.

Such restrictions will likely limit the growth in the sector and severely restrict the ability of MPA member companies to distribute product via this nascent distribution medium.

Recording industry:

The recording industry is also severely hampered both in the fight against piracy and in helping to develop a thriving music culture in China by the many and varied market access and investment restrictions that affect the entire entertainment industry, specifically:

Censorship: Only legitimate *foreign-produced* music must be approved by Chinese government censors. Domestically produced Chinese sound recordings are NOT censored. China should terminate this discriminatory process. Censorship offices are also woefully understaffed, causing long delays in approving new recordings. Censorship should be industry-administered, as in other countries. If not possible, steps must be taken to expedite the process so that legitimate music can be promptly marketed, preventing pirates from getting there first. For example, staff shortages must be filled. In the near-term, China should be pressed for a commitment to (1) end discrimination in censorship; and (2) complete the approval process within a reasonable period (e.g., a few days). In the long term, censorship should be abolished.

Producing and publishing sound recordings in China: U.S. record companies are skilled at and desirous of developing, creating, producing, distributing and promoting sound recordings by Chinese artists, for the Chinese market and for export from China. However, onerous Chinese restrictions prevent this from occurring. For example, for a sound recording to be brought to market, it must be released through an approved “publishing” company. Currently only state-owned firms are approved to publish sound recordings. China should end this discrimination and approve foreign-owned production companies.

Further, production companies (even wholly owned Chinese ones) may not engage in replicating, distributing or retailing sound recordings. This needlessly cripples the process of producing and marketing legitimate product in an integrated manner. China should permit the integrated production and marketing of sound recordings.

U.S. record companies may market non-Chinese sound recordings only by (1) licensing a Chinese company to produce the recordings in China or (2) importing finished sound recording carriers (CDs) through the China National Publications Import and Export Control (CNPIEC). China should permit U.S. companies to produce their own recordings in China and to import directly finished products.

Distribution of sound recordings: Foreign sound recording companies may own no more than 49% of a joint venture with a Chinese company. However, the recently concluded “Closer Economic Partnership Agreement” (CEPA) between China and Hong Kong permits Hong Kong companies to own up to 70% of joint ventures with Chinese companies engaged in distributing audiovisual products. China should grant MFN status to U.S. record producers per the terms of the CEPA.

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